

## **The Value of External Hires: Effects of External Versus Internal CEO Successors on Firm Performance over Time**

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Managing the talent pipeline is a critical risk area for organizations in today's business environment. Chief Human Resource Officers are particularly concerned with ensuring the organization has a deep talent bench to replace executives who depart or retire. Both internal and external hires are likely to bring significant benefits to the organization. The most important consideration, however, should be a focus on the capabilities needed in the role for which an individual is to be hired.

Internal hires have firm-specific knowledge, a working understanding of the firm, and well-developed internal relationships. Promoting from within also is likely to ensure continuity of firm strategies, as internal executives are likely to be committed to the organization's course of action. Thus, internal hires should be preferred when existing organizational knowledge is relevant to the organization's future strategic direction.

On the other hand, external hires bring a wealth of experience and knowledge that is likely to be new to the organization. This knowledge may be industry specific, which allows application of important industry principles to the firm in a novel way, or it may be general, in which the hire may impart a wide range of general management knowledge to improve the organization's operations. In addition, external hires are not wedded to prior strategic courses of action. Thus, external hires are often thought to be preferred when new knowledge is important to the organization's future strategic direction.

While consultants, academics, and executives have debated the merits of hiring internally versus externally, the relationship between talent origin and subsequent performance is often assumed to be constant over time. The dynamically changing business environment due to globalization and technology advances, however, calls into question whether this assumption is true. In short, the changing nature of today's business environment requires organizations to adapt on a more consistent basis than in prior years. Yesterday's firm-specific knowledge may be less beneficial in tomorrow's business world than knowledge which may be acquired externally.

To test this theory, we identified and examined 18 academic studies which explored the relationship between new CEO successor origins (external vs. internal hires) and subsequent firm performance with data ranging from 1970 to 2007 among publicly traded companies. In particular, we focused on study correlations between CEO origin and subsequent performance and how this relationship changed over time.

For internal vs. external hires, time tells a compelling story regarding their differential impacts on firm performance. Internal hires experienced negative performance in the early window of study timeframes we examined, with the relationship turning positive for most of the 1980s and 1990s. Starting in approximately 2002, however, internal CEO successors see significant negative performance, suggesting that the value of hiring CEOs from within the organization has decreased significantly in today's business environment.

For external hires, there was a significant positive relationship in the 1970s. Starting in approximately 1984, however, this relationship turned negative until roughly 2002 (notice this represents the same point at which the relationship for internal CEO successors turned negative). From 2002 onward, we see an increasing positive effect of external CEO hires on subsequent firm performance.

In short, our data suggests that the relationship between CEO origin and subsequent firm performance has changed dynamically over the past 40 years. External CEO hires in today's business environment appear to add significantly greater value than internal CEO hires. As the business world becomes increasingly complex and capabilities for success in the future become ever more uncertain, organizational management and boards of directors should be aware that hiring from outside the organization may be more beneficial now than at any period in recent history.



